IVEN R. TAUB
ATTORNEY AT LAW

Timothy P. Fisher
Of Counsel
Schwartzman Garelik
Walker & Troy, P.C.[Δ]
Of Counsel

[Δ]Members Admitted in
New York and New Jersey

355 LEXINGTON AVENUE
20TH FLOOR
NEW YORK, NEW YORK 10017

TEL: (212) 286-7700
TEL: (212) 686-6866

FAX: (212) 481-2488
E-mail: Ivenesq@aol.com

WESTCHESTER OFFICE
550 MAMARONECK AVENUE
SUITE 510
HARRISON, NEW YORK 10528

TEL: (914) 381-7400
FAX: (914) 381-7406
BY APPOINTMENT ONLY

April, 2009

MEMORANDUM

TO: OUR CLIENTS AND THEIR ADVISORS

RE: ESTATE PLANNING OVERVIEW

We frequently receive questions concerning estate planning. Some of these issues have been discussed in our previous newsletters, estate planning memorandums and individual client meetings. However, with the enactment of The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), we thought it would be helpful to provide you with an updated comprehensive memorandum on the subject. We have therefore prepared the following summary of various estate planning concepts to assist you in gaining a working knowledge on this subject which includes the relevant portions of EGTRRA, including for historic purposes those provisions which were effective for 2002 and 2003.

I. Estate Planning Overview.

A. Increase of Exemption Amounts and Reduction of Estate Tax Rates. U.S. citizens and resident aliens are entitled to transfer a statutory amount ("exemption amount") without exposure to estate tax. For 2009 an individual can transfer $3,500,000; a husband and wife with proper planning can transfer $7,000,000 combined. However the lifetime gift exemption is $1,000,000 per person. The exemption amount (which will also be applicable for the Generation Skipping Tax ("GST")) was increased to $3.5 million in 2009. The Estate and GST tax rates were reduced pursuant to the following schedule:

Year	Top Estate & GST Tax Rate	Estate & GST Exemption Amt	Gift Tax Exemption Amt [2]
2002	50%	$1,000,000[1]	$1,000,000
2003	49%	1,000,000[1]	1,000,000
2004	48%	1,500,000	1,000,000
2005	47%	1,500,000	1,000,000
2006	46%	2,000,000	1,000,000
2007	45%	2,000,000	1,000,000
2008	45%	2,000,000	1,000,000
2009	45%	3,500,000	1,000,000
2010	Estate Tax & GST Repealed	All	1,000,000
2011	55%	1,000,000	1,000,000

[1] The GST exemption amount for 2002 was $1,060,000. For 2003 the GST exemption amount was $1,100,000.

[2] Donors can not utilize the estate tax exemption amount for gifts after 2003.

Planning Note: Please review your Will or Living Trust to ensure that the unified credit ("By-Pass") provision contains a formula that will automatically increase with the law change. As the unified exemption amount increases each year, please be certain that the assets in each spouse's individual name increases to match the new exemption amount.

B. Repeal of Estate Tax and GST. Effective January 1, 2010, the estate tax and GST will be repealed. However, due to a quirk in the Congressional budgetary process, the repeal as well as all of the new provisions of the EGTRRA will be undone and the laws will revert back to 2001 status, which means that the exemption amount will revert back to $1,000,000 unless Congress takes additional actions.

C. Basis Adjustment. With the repeal of the estate tax, the stepped-up basis of property transferred at death will no longer be used and a modified carry-over basis rule will be adopted. Beginning in 2010, the adjusted cost basis of the assets owned by the decedent will be increased by a total of $1.3 million. The basis of property transferred to the surviving spouse will be increased by an additional $3 million for a total basis adjustment of $4.3 million. The executor shall have the responsibility of allocating the $1.3 million basis adjustment to the assets of his or her choice irrespective of the ultimate beneficiary. The basis allocation will not be permitted for assets received by the decedent from nonspousal donors within 3 years of death, property which is considered income in respect of a decedent or stock in foreign investments and personal holding companies. However, the income-tax exclusion for up to $250,000 of gain on the sale of a principal residence is extended to estates and heirs.

D. <u>Unlimited Marital Deduction</u>. There is an unlimited marital deduction for gifts and death transfers to U.S. citizen spouses. It is the intent of Congress that the family unit only be taxed once, upon the death of the second spouse. This enables the surviving spouse to retain all of the combined assets of the couple to provide the necessary income to live on. Once the second spouse dies, the assets of the second estate are subject to the full estate tax, with adjustment for the exemption amount discussed above. Note: If the surviving spouse is <u>not</u> a U.S. citizen, a Qualified Domestic Trust ("QDT") must be established for the surviving spouse. If the QDT is not established, estate taxes will be due on the death of the first spouse. See Paragraph G below.

E. <u>Interplay of Unified Credit and Unlimited Marital Deduction</u>. Many married couples often unwittingly transfer all of their assets upon the death of the first spouse to the second spouse. While there is no tax liability upon the first death, this strategy fails to take advantage of the unified credit which was available to the deceased spouse. The unfortunate result is that all of the assets of the couple wind up in the taxable estate of the surviving spouse. As a result, upon his or her subsequent death, only the surviving spouse's exemption amount is taken advantage of instead of both exemption amounts. In addition, this approach may also not take full advantage of the basis adjustment as discussed above.

The ideal plan should take advantage of both exemption amounts and shelter assets from estate tax equal to two times the exemption amount. To successfully utilize the exemption amount through either lifetime or estate planning each spouse must have assets in his and her individual name equal to the exemption amount. We include in the Living Trust or Will a "By-Pass Trust" provision to which an amount equal to the exemption amount is transferred upon the death of the first spouse. The terms of the By-Pass Trust provide the surviving spouse with all the income from the principal annually. In addition, principal can be invaded on behalf of the surviving spouse. However, we recommend that the surviving spouse spend his or her own individual assets first since they may be subject to estate tax in the future. <u>The assets of the By-Pass Trust will forever escape estate tax</u>. Any future appreciation in the By-Pass Trust assets will also escape estate tax. If the surviving spouse's assets are depleted then, of course, the principal held in the By-Pass Trust can be used for his or her benefit.

The tax advantage of this strategy is that the By-Pass Trust is intentionally set up not to qualify for the marital deduction and is therefore included for tax purposes in the first estate. As explained above, the amount included in the By-Pass Trust is then sheltered by the exemption amount. The use of the By-Pass Trust removes assets equal to the exemption amount from the second estate. Accordingly, when the surviving spouse dies, there is significantly less than the full amount of the combined estates subject to estate tax; the surviving spouse will then have his or her own exemption amount additionally available to offset against the estate tax.

F. State Inheritance and Estate Taxes - Phase Out of State Death Tax Credit - In their own way, Florida, New York, Connecticut and New Jersey each impose a tax upon the death of an individual. Each state has its own format for imposing these taxes. The Federal Government had previously provided a credit for state death taxes paid based on a statutory schedule. This credit was phased out as listed in the schedule below:

Year	Phase-Out %
2002	25%
2003	50%
2004	75%
2005	No credit - Deduction on Form 706

The states may impose death taxes greater than the Federal state death tax credit schedule. The phase out of the state death credit may ultimately prompt states to change their estate tax schemes. Summarized below are the tax schemes for each of the above-mentioned states:

1. Florida - Florida imposes what is known as a "soak-up" tax. The estate tax due to Florida is equal to the maximum Federal state death tax credit granted. Since there is no credit given, then Florida does not require any tax to be paid. The net result to the Estate is that no additional estate tax is actually expended. Previously, instead of 100% being paid to the Federal Government, a small portion was paid to Florida and the balance was paid to the Internal Revenue Service.

2. New York - New York previously maintained an independent estate tax rate schedule. The estate tax schedule was greater than the Federal state death tax credit. As a result, if you were subject to estate tax in New York, a greater combined estate tax would have been paid than if the person died subject to tax in Florida. As of February 1, 2000, the New York estate tax was reduced and converted to a "soak-up" tax similar to Florida.

The gift tax imposed by New York State was repealed as of January 1, 2000. Through a technical glitch, New York does not recognize the exemption amount in excess of $1 million. Accordingly, New York imposes an estate tax on taxable estates (without regard to previous gifts) in excess of $1 million. There is legislation proposed in the Assembly (to increase the estate tax exemption to match the Federal exemption. New York does not impose any gift tax, which is valuable for planning purposes.

3. New Jersey - New Jersey imposes both an inheritance tax upon the transfer of Estate assets as well as a tax upon the Estate itself.

a. Inheritance Tax - There is no inheritance tax imposed on family transfers if the beneficiary is a surviving spouse, parent, grandparent or child. There is a graduated tax rate that is imposed upon all other beneficiaries. These tax rates are in excess of the Federal state death tax credit schedule.

b. Estate Tax - the New Jersey Estate Tax is also a "soak-up" tax equal to the maximum Federal state death tax credit, reduced by the amount of any inheritance tax paid. If the inheritance tax is greater than the amount of the Federal state death tax credit, there is no Estate tax due.

4. Connecticut - Connecticut has the same death tax system as New Jersey except that the exemption on the inheritance tax is limited solely to a transfer to a surviving spouse. Connecticut also has a progressive tax rate system.

G. Status as Resident Aliens. Special planning is required where either a husband or wife is not a citizen of the United States. If a non-citizen is the surviving spouse, the first estate will not be entitled to the use of the unlimited marital deduction. Resident aliens are entitled, however, to the use of the exemption amount discussed above. The Internal Revenue Code does provide a method to defer payment of the estate tax upon the death of the first spouse which for timing purposes is analogous to the unlimited marital deduction. To qualify for deferral treatment, assets bequeathed to the surviving spouse must be transferred to a Qualified Domestic Trust ("QDT"). The statutory QDT has the following requirements:

a. at least one trustee of the trust must be an individual citizen of the United States or a domestic corporation;

b. the trustee must withhold estate tax from any distribution of principal from the trust. The amount to be withheld is calculated based upon the estate tax return (Form 706) previously filed for the deceased spouse. The amount distributed is added back to the decedent's taxable estate and results in the principal being taxed at the decedent's highest marginal tax bracket. The terms of the trust can be liberal on behalf of the surviving spouse. Income can be paid annually for the benefit of the spouse. Principal invasion privileges can be granted but will be subject to the withholding requirements discussed above. Upon the death of the surviving spouse the principal will be taxed as though it was included in the estate of the deceased spouse.

c. for gift tax purposes, the annual gift exclusion is $100,000 per year, as adjusted for cost of living increases. For 2009 the annual gift exclusion was increased to $131,000 for transfers to non citizen spouses.

II. Planning Opportunities.

A. Estate Tax Exposure. Estate and gift tax exposure can be further reduced, as will be discussed below, by making annual gifts, transferring life insurance out of your estate, acquiring new life insurance and adopting aggressive estate planning techniques for multiple generations. However as noted in the schedule in Paragraph IA. above, the maximum exemption amount available to shelter cumulative lifetime transfers (other than the annual $13,000 gifts) is limited to $1 million, regardless of the exemption amount available for estates. Beginning in 2010, cumulative lifetime transfers in excess of $1 million are subject to a gift tax assessed at the top individual income tax rate in effect at the time of the gift (anticipated to be 35%). This provision was enacted to prevent taxpayers from transferring income generating property from higher to lower rate taxpayers.

B. Annual Gifts. Each individual is currently entitled to make an annual gift to anyone of their choice in the amount of $13,000. A husband and wife can make a combined gift of $26,000. Please note that this transfer must be of a present interest. Ordinarily, a transfer in trust does not qualify as a present interest since the beneficiary does not have an immediate right to the assets and must wait for their remainder interest. However, as a result of a Tax Court case known as "Crummey", when certain language is added to the trust, we can convert a transfer in trust to a present interest. The "Crummey" provision grants the trust beneficiary a window period of 30-45 days to elect to withdraw the annual gift from the trust. If the beneficiary chooses not to make such withdrawal, the gift remains as part of the principal. As a result of a recent case, the use of the

Crummey provision has become more flexible as the Crummey withdrawal power can be expanded to contingent beneficiaries. The annual gift is very valuable and should not be ignored as over time the accumulation of these gifts will become quite sizeable.

The $13,000 annual exclusion can be expanded for transfers paid on behalf of an individual directly to an educational organization for tuition or to a medical care provider. Also, the future appreciation of the assets transferred are also excluded from estate tax.

Effective January 1, 1999, the $10,000 annual exclusion began to increase in increments of $1,000 based upon cost of living adjustments. For 2009, the annual gift exclusion is $13,000.

C. Transfer of Life Insurance. After certain technical procedural steps are taken, any existing life insurance policies can be transferred to an irrevocable trust. If the transferor of the policy outlives the transfer by three (3) years, once the insured retains no incidents of ownership in the trust, the insurance proceeds will not be included in the insured's estate. The trust should be established so that the insured can make annual gifts to the trust to enable the trustee to continue to pay premiums as well as to enable each gift to the trust to qualify for the present annual gift exclusion.

D. Acquisition of New Life Insurance. Often shortages between the face value of the insurance policies currently held and/or other liquid assets and the estimated estate tax due in the future, as well as funds providing for other family needs, are funded through the acquisition of "second to die" life insurance. This policy insures the combined lives of the husband and wife. The death benefit is paid after the second spouse dies at the time estate taxes are due. Based on two lives, the insurance premiums may be reduced by a significant amount. There will be no three year waiting period because the policy was never transferred by the insured to the trust. The same procedural steps discussed above will be taken insofar as payment of premiums and other technical provisions.

E. Retirement Plan Assets. These assets are subject to income tax upon distribution regardless of the recipient as well as estate tax upon the death of the owner. Effective January 1, 1997, the 15% excise tax penalty on excess distributions from qualified plans and IRAs during one's lifetime and the excess accumulations at death has been repealed.

F. Exclusion for Family Owned Business. For decedents owning a qualified family owned business interest or family farm, a partial exclusion (deduction) from estate taxes will be available effective for decedents dying after December 31, 1997. This exclusion is coordinated with the exemption amount discussed above. The maximum benefit available between the business exclusion and exemption amount combined totals $1.3 million. For decedents dying in 2002 or 2003, the maximum business exclusion was $300,000 when combined with the exemption amount of $1,000,000. The business credit was repealed after 2003 when the exclusion amount increased to $1,500,000. This exclusion is still available for New York State Estate Tax purposes.

G. <u>Generation Skipping Tax</u>. Frequently, the beneficiaries of substantial estates never utilize their inherited assets during their lifetimes and those assets will be subject to a second estate tax in their own estates. GST planning contemplates transfers from grandparents to grandchildren to avoid estate tax being imposed at the child's generational level. Assets can be placed in trust for the benefit of the child for his or her lifetime without an estate tax being imposed on the child's estate.

However, the GST is imposed at the highest estate tax rate in effect at the triggering event for generation skipping transfers. The GST can be reduced by utilizing the cumulative GST exemption available to each grandparent for all lifetime and estate transfers. Once the GST exemption is allocated to a transfer, all future appreciation is covered by the exemption. Aggressive use of the GST exemption is also available with regard to life insurance trusts and other transactions. In addition, a transfer that qualifies for the $13,000 annual gift exclusion will automatically be free of GST implications and will <u>not</u> count against the GST exemption. In many instances where the child has predeceased the grandchild, transfers to the grandchild will not be subject to the GST at all.

Effective January 1, 1999, the original $1,000,000 GST exemption (enacted in 1986) increased in increments of $10,000 for cost of living adjustments. For 2009, the GST exemption is $3,500,000. As listed in the schedule in Paragraph 1A. above, the GST exemption is now the same as the estate tax exemption amount. The GST will be repealed in 2010 subject to the same sunset provision in 2011 as the repeal of the estate tax. Additionally, EGTRRA has liberalized the rules for allocating GST exemptions and splitting trusts for GST purposes.

H. <u>Other Estate Planning Techniques</u>.

1. <u>Grantor Retained Income Trust ("GRIT")</u>. A more advanced estate planning technique is to gift a future remainder

interest in property. The property is held in trust for a specified term of years with income paid to the grantor. Upon expiration of the term, the principal passes to the remainder beneficiaries. For IRS gift tax valuation purposes, a discount is applied to the amount of the gift. Based on the term of the trust, this discount may be quite substantial and may be valued as high as a 75% discount. However to retain the benefit of the discount, the grantor must outline the term of the trust.

2. Qualified Personal Residence Trust ("QPRT"). Utilizing the GRIT concept, a personal residence, including a vacation home, can be transferred into a trust for a term of years. The Grantor enjoys the benefits of residing in the residence for the term of years he or she selected. At the conclusion of the term, the residence reverts to the remainder beneficiaries (i.e. children or grandchildren). Often the beneficiaries then rent the house back to the Grantor which creates other tax advantages. The QPRT receives similar favorable discount treatment as the GRIT in valuing the gift.

3. Charitable Remainder Trust ("CRT"). An estate planning strategy that allows you to support a favorite charity, while providing an income stream for you and your family, is the Charitable Remainder Trust. The Grantor establishes the trust by making a contribution of property. The Grantor retains an income interest while the charity receives the property at the end of the term of the trust. The Grantor is entitled to a current charitable income tax deduction. The utility of a CRT can be augmented by combining it with an insurance trust. The Grantor often acquires life insurance to replace the value of the property contributed to the trust. The most effective use of a CRT is to contribute highly appreciated and low yielding property to the trust. The trust can sell the assets without being subject to the capital gains tax that the Grantor would have paid if he or she had sold the assets. The tax-exempt trust then reinvests 100% of the sale proceeds to obtain a higher yield that is payable to the Grantor. If the charitable income tax deduction cannot be fully utilized in the year of the gift, it can be carried over to the five succeeding years. The savings resulting from the income tax deduction may be either reinvested or used to acquire life insurance, presumably equal to the post estate tax value of the property initially transferred to the charitable trust.

The life insurance is acquired by an irrevocable trust naming the Grantor's children or other family members as beneficiaries. When the Grantor dies, the charity receives the proceeds of the CRT while the insurance proceeds pass to his or her heirs free of Federal estate tax. As a result, the value of the contributed property has been removed with minimal gift or estate tax with an increase of the Grantor's annual income stream. The amount of income taxes saved as a result of the charitable income tax deduction will determine the amount of insurance that can be acquired. Quite frequently the income tax savings generated will greatly exceed the amount of money necessary to acquire an insurance policy.

4. Family Limited Partnership ("FLP"). The FLP creates a structure which enables assets to be transferred with substantial valuation discounts for gift tax purposes. The Grantor establishes a limited partnership naming himself or herself, or a wholly owned entity, as the general partner and initially owns all of the limited partnership interests. Over time, the Grantor will attempt to transfer the majority of the limited partnership interests to his or her heirs. As a general partner, the Grantor retains significant management control over the property interests which are transferred, such as investments and distributions. The FLP also provides protection against creditors of the beneficiaries. The FLP facilitates making $13,000 annual exclusion gifts by merely transferring limited partnership interests. The discounts which can often range from 33%-40% or higher, depending upon the nature of the property in the FLP, increases the amount of property that can be gifted under the $13,000 annual exclusion gift rule. This approach is also utilized for transferring ownership interests in limited liability companies.

The Grantor can also utilize each of these techniques to exhaust the gift tax exemption amount available to him or her of $1 million.

If you have any questions concerning this material, please contact me.